INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and Regulations involved	2
Statement	2
Argument	6
Conclusion	11
Appendix	12

CITATIONS

Cases:

Becker v. *Anheuser-Busch*, 120 F. 2d 403, certiorari denied, 314 U. S. 625	7
Boehm v. *Commissioner*, 326 U. S. 287, rehearing denied, 326 U. S. 811	7, 8, 10
Cass v. *Helvering*, 83 F. 2d 841	8
Kansas City Southern Ry. Co. v. *Commissioner*, 52 F. 2d 372, certiorari denied, 284 U. S. 676	10
Keeney v. *Commissioner*, 116 F. 2d 401	8
Mahler v. *Commissioner*, 119 F. 2d 869, certiorari denied, 314 U. S. 660	8
Old Colony R. Co. v. *Commissioner*, 284 U. S. 552	10
Superior Coal Co. v. *Commissioner*, 145 F. 2d 597, certiorari denied, 324 U. S. 864	10
Thompson v. *Texas Mexican R. Co.*, 328 U. S. 134	11

Statutes:

Internal Revenue Code, Sec. 23 (26 U.S.C. 1946 ed., Sec. 23)	6, 7, 11, 12
Interstate Commerce Act, c. 104, 24 Stat. 379, Sec. 1 (49 U.S.C. 1946 ed., Sec. 1(18))	8

Miscellaneous:

Treasury Regulations 111:	
Sec. 29.23(e)-1	7, 9, 12
Sec. 29.23(e)-3	7, 12
Sec. 29.23(f)-1	7, 14

In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 478

MINE HILL & SCHUYLKILL HAVEN RAILROAD COMPANY, PETITIONER

v.

FRANCIS R. SMITH, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 24a-28a) is reported at 88 F. Supp. 803. The opinion of the Court of Appeals (R. 32-38) is reported at 184 F. 2d 422.[1]

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[1] Two cases, involving a common question but different taxable years, were instituted by the taxpayer and were consolidated in the courts below (R. 1a-2a, 31). The opinion of the District Court in one of the cases (R. 24a-28a) was adopted as its (unreported) opinion in the other (R. 23a). A single opinion was written by the Court of Appeals (R. 32-38).

JURISDICTION

The judgments of the Court of Appeals were entered on October 4, 1950 (R. 39, 40). The petition for a writ of certiorari was filed on January 2, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the Court of Appeals erred in affirming the District Court's determination that losses claimed by taxpayer for the taxable years 1942 and 1943 were not sustained during those years, and hence were not deductible in those years under Section 23(f) of the Internal Revenue Code.

STATUTE AND REGULATIONS INVOLVED

These appear in the Appendix, *infra*, pp. 12-14.

STATEMENT

The facts as stipulated (R. 3a-14a, 15a-22a), and found by the District Court (R. 23a-24a), may be summarized as follows:

Taxpayer-corporation owns certain railroad lines in eastern Pennsylvania which are leased to the Reading Company under a 999-year lease entered into in 1896 (R. 3a, 24a). The lease required the Reading Company to maintain the lines in good order and repair, but expressly excepted from this requirement any lines or portions thereof (R. 6a-7a, 24a)—

> which are or may be from time to time used exclusively by any one colliery which is now or may hereafter be abandoned, or the work-

> ing thereof may be discontinued, or which does not furnish and supply sufficient traffic to pay the needful repairs and expenses of the portion of said railroad leading to said colliery.

In 1941, taxpayer and the Reading Company jointly filed an application with the Interstate Commerce Commission for a certificate of public convenience permitting taxpayer to abandon certain branch lines of a total distance of 5.89 miles (R. 4a-5a). The application stated that these lines had not been operated or maintained since 1933, that practically all the ties were decayed, that there had been no train service or traffic over them for many years, and that the collieries which these lines were constructed to serve had been abandoned for some years (R. 8a-10a). The application set forth the following reasons for requesting the certificate (R. 11a):

> (a) As shown in answer to Question No. 2, the branches and portions of branches involved in this application were constructed and have been used exclusively to serve anthracite collieries and washeries which have been abandoned for some years. * * *
>
> (b) No train service has been operated for the past seven to thirteen years over the lines of railroad which applicants here seek to abandon, and no need for future train service over these lines is anticipated.
>
> (c) Applicants desire to salvage the rails and other track materials remaining on the lines of railroad in question before they are stolen.

In 1942, the Interstate Commerce Commission granted the application on the grounds requested and issued a certificate of convenience authorizing taxpayer and the Reading Company to abandon the lines (R. 5a). The certificate recited that (R. 13a-14a)—

> The collieries located on the segments have been abandoned for many years. The last train movement over any portion of the lines sought to be abandoned was more than seven years ago. Since discontinuance of service, maintenance has been neglected, practically all the ties have decayed, and a substantial part of the rail and track material has been stolen. The total net salvage value of the recoverable material is estimated by the applicants to be $5,096. There are no stations on the lines, and few, if any, inhabitants in the territories tributary thereto.

In its income tax return for 1942, taxpayer claimed a loss deduction of $95,078.05, on the theory that the lines had been abandoned in that year. The amount of loss claimed represented taxpayer's investment in the lines less salvage value. The claimed loss was disallowed by the Commissioner, and taxpayer paid the resulting deficiency. Thereafter, taxpayer filed a claim for refund, which was rejected, and suit for refund followed. (R. 3a-4a.) The District Court held that the loss was sustained prior to the taxable year (1942) in which it was claimed as a deduction, and accordingly entered

judgment for the Collector (R. 23a, 24a-28a). The Court of Appeals affirmed (R. 32-38).

In 1943, taxpayer and the Reading Company jointly filed another application with the Interstate Commerce Commission for a certificate of public convenience permitting taxpayer to abandon a certain branch line of a total distance of 2.06 miles (R. 16a-17a, 24a). The application stated that the line had not been operated or maintained for the past 12 years, that there had been no train service or traffic over it for many years, and that the colliery served by it had long since been abandoned (R. 18a-20a). It set forth the following reasons for requesting the certificate (R. 20a):

> Applicants desire to abandon the line since it no longer serves any industry, train service has not been operated thereover within the last twelve years, and applicants desire to salvage the rails and other track materials remaining in the line so as to put the same to economic use and to prevent theft thereof.

Within the same year, the Interstate Commerce Commission granted the application on the grounds requested and issued a certificate of convenience authorizing taxpayer and the Reading Company to abandon the line (R. 17a). The certificate recited that (R. 22a):

> The anthracite colliery formerly served long since has been abandoned, and no trains have operated over the line for at least 12 years. Few, if any, inhabitants reside in the tributary

> territory, and no one is dependent upon the line for transportation service. In its isolated location the track materials are subject to theft, and the applicants desire to salvage such rails and fastenings as may still remain for use on other parts of their system or for scrap purposes.

In its income tax return for 1943, taxpayer claimed a loss deduction of $69,324.28, on the theory that the line had been abandoned in that year. The amount of loss claimed represented taxpayer's investment less estimated salvage value. Actual salvage exceeded the estimated salvage, reducing the claimed loss to $68,060.22. The Commissioner disallowed the loss, and taxpayer paid the resulting deficiency. Thereafter, taxpayer filed a claim for refund, which was rejected, and suit for refund followed. (R. 15a-16a, 24a.) The District Court held that the loss was sustained prior to the taxable year (1943) in which it was claimed as a deduction, and accordingly entered judgment for the Collector (R. 24a-28a). The Court of Appeals affirmed (R. 32-38).

ARGUMENT

This case presents a question of pure fact. Neither a conflict of decisions nor an important question is involved.

1. Section 23(f) of the Internal Revenue Code (Appendix, *infra*, p. 12) authorizes a deduction from gross income of "losses sustained during the taxable year." The long-standing applicable Treas-

ury Regulations provide that the loss must be "actually sustained during the taxable period for which allowed." Secs. 29.23(e)-1 and 29.23(f)-1 of Treasury Regulations 111. (Appendix, *infra*, pp. 12, 14.)[2] The Regulations further provide that in the case of "Loss of Useful Value" of business assets, the difference between the basis of the property and its salvage value may be deducted in the year in which the loss occurs. Sec. 29.23(e)-3 of Treasury Regulations 111. (Appendix, *infra*, pp. 12-13.) The question of the particular year in which a loss is actually sustained, and hence deductible for tax purposes, is purely one of fact; the burden of proof rests upon the taxpayer, and the trial court's determination may not be disturbed unless clearly erroneous. *Boehm* v. *Commissioner*, 326 U.S. 287, rehearing denied, 326 U.S. 811; *Becker* v. *Anheuser-Busch*, 120 F. 2d 403 (C.A. 8th), certiorari denied, 314 U.S. 625.

The District Court concluded (R. 23a, 24a-28a) that the losses here in question were actually sustained prior to the taxable years in which they were deducted.[3] Its decision is amply supported by the record, and was correctly affirmed by the court below. Taxpayer leased various railway

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[2] Code Section 23(e) deals with losses by individuals, while Section 23(f) deals with losses by corporations. By Section 29.23(f)-1 of Regulations 111, the Regulations addressed to Section 23(e) are made applicable to Section 23(f). The Regulations under the Code are substantially the same as those under corresponding sections of prior Revenue Acts.

[3] The District Court was under no duty, of course, to make an affirmative finding as to when the losses did in fact occur.

lines to the Reading Company under a lease which required the lessee to maintain them in good order, but which expressly excepted from this requirement any lines serving a colliery which might be abandoned (R. 3a, 6a-7a, 24a). In 1941, taxpayer and the lessee jointly filed an application with the Interstate Commerce Commission for a certificate of convenience authorizing abandonment of certain branch lines.[4] The application stated that the colliery served by these lines had been abandoned many years before, that the lines had not been used or maintained for at least 7 years and were in a state of decay, and that taxpayer wished to salvage them before they were stolen. (R. 8a-11a.) The Interstate Commerce Commission issued the requested certificate on the grounds stated in the application (R. 12a-14a). In its 1942 return, taxpayer claimed as a loss the difference between its investment in these lines and their salvage value (R. 3a). In 1943, taxpayer and the lessee jointly filed another application with the

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It is sufficient that it found they were not sustained during the taxable years involved. *Boehm* v. *Commissioner, supra; Keeney* v. *Commissioner,* 116 F. 2d 401, 403 (C.A. 2d); *Mahler* v. *Commissioner,* 119 F. 2d 869, 871 (C.A. 2d) certiorari denied, 314 U.S. 660; *Cass* v. *Helvering,* 83 F. 2d 841 (C.A. 8th).

[4] Sec. 1(18) of the Interstate Commerce Act, c. 104, 24 Stat. 379, as amended (49 U.S.C. 1946 ed., Sec. 1(18)), provides that "* * * no carrier by railroad subject to this part shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment."

Interstate Commerce Commission for a certificate authorizing abandonment of certain other branch lines, also on the ground that the collieries served thereby had been abandoned many years before, that the lines had not been used or maintained for at least 12 years, and that taxpayer wished to salvage them (R. 18a-20a). This application likewise was granted on the grounds requested (R. 21a-22a). In its 1943 return, taxpayer deducted as a loss the difference between its investment in these lines and their salvage value. (R. 15a.)

On the basis of taxpayer's own averments in the applications to the Interstate Commerce Commission, the District Court was unquestionably justified in concluding (R. 24a-25a) that the properties became useless and were abandoned long before the taxable years in which taxpayer seeks to deduct the losses. Significantly, the deduction claimed in each case is the difference between taxpayer's investment (basis) in the properties and their "salvage" value. (R. 3a, 15a-16a.) Under the applicable Treasury Regulations, a loss so computed represents a "Loss of Useful Value" and may be claimed only in the year in which the property ceases to have "usefulness in the business" by reason of "some change in business conditions." Sec. 29.23(e)-3 of Regulations 111. As is plain from taxpayer's "Return to Questionnaire" in its applications to the Interstate Com-

merce Commission (R. 8a-11a, 18a-20a), the properties here involved had lost their usefulness long prior to the taxable years.

2. Nothing in the taxing statute or elsewhere warrants taxpayer's assumption (Pet. 5-6) that a loss of useful value of railroad property must be deemed to have been actually sustained by the taxpayer-owner in whatever year the taxpayer (or its lessee) chooses to apply to the Interstate Commerce Commission for a certificate of public convenience authorizing abandonment of the property. The requirements of the Interstate Commerce Act, whose purpose is to regulate commerce, are not determinative of tax liability under the Revenue Act. *Old Colony R. Co.* v. *Commissioner,* 284 U.S. 552, 562; *Kansas City Southern Ry. Co.* v. *Commissioner,* 52 F. 2d 372, 377-378 (C.A. 8th), certiorari denied, 284 U.S. 676. The year in which taxpayer and its lessee jointly applied to the Interstate Commerce Commission for authority to abandon the properties was but one of many relevant factors which the trial court properly considered. It was not conclusive of when the loss in fact occurred for tax deduction purposes. *Boehm* v. *Commissioner, supra; Superior Coal Co.* v. *Commissioner,* 145 F. 2d 597 (C.A. 7th), certiorari denied, 324 U.S. 864. To hold otherwise would permit the taxpayer to accelerate or postpone the year of deduction, and defeat the statutory mandate that losses are deductible in the years "sustained".

3. The only case upon which taxpayer relies for conflict (Pet. 6) is *Thompson* v. *Texas Mexican R. Co.*, 328 U.S. 134. The issue there has no relation to the one here presented. The question in that case was whether maintenance of a suit in a state court, against a railroad company which was in reorganization under Section 77 of the Bankruptcy Act, was precluded by a stay order issued by the bankruptcy court and the provisions of Section 77 of the Bankruptcy Act. The case has no bearing on the question here involved, namely, whether the taxable year in which a loss is claimed as a deduction is the year in which the loss was actually "sustained" within the meaning of Section 23(f) of the Internal Revenue Code and the implementing Treasury Regulations.

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JANUARY, 1951

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(f) *Losses by Corporations.*—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.23(e)-1. *Losses by Individuals.*— * * * In general losses for which an amount may be deducted from gross income must be evidenced by closed and completed transactions, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. * * *

SEC. 29.23(e)-3. *Loss of Useful Value.*— When, through some change in business conditions, the usefulness in the business of some or all of the capital assets is suddenly termi-

nated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (adjusted as provided in section 113(b) and sections 29.113-(a)(14)-1 and 29.113(b)(1)-1 to 29.113(b)-(3)-2, inclusive) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income. * * *

* * * * *

SEC. 29.23(f)-1. *Losses by Corporations.*— * * * The provisions of sections 29.23(e)-1 to 29.23(e)-5, inclusive, and section 29.23(i)-1 are in general applicable to corporations as well as individuals. * * *

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Petitioner,

v.

FRANCIS R. SMITH, Collector of Internal Revenue,

Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

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CASES CITED.

	Page
Old Colony R. Co. v. Commissioner, 284 U. S. 522 (1932)	2
Thompson v. Texas Mexican Ry. Co., 328 U. S. 134 (1946)	3

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

REPLY BRIEF FOR PETITIONER.

Petitioner files this reply brief to call the Court's attention to three important errors in respondent's brief in opposition.

1. This case does not present "a question of pure fact" (Resp. brief, p. 6). Respondent in his brief continues to ignore petitioner's primary contention which presents a question of law. If petitioner in addition to being the owner were also the operator of the abandoned lines (instead of lessor thereof) it might reasonably be claimed that the question of whether or not its abandonment losses were sustained in the years 1942 and 1943 is one of "pure fact". This, however, is not the case.

Petitioner is a lessor. Its lessee is in possession and control and is the operating railroad. The lessee has covenanted to surrender the leased property to petitioner at the termination of the lease in the same good order and condition as it was at the beginning (R. 3a, 6a).

Petitioner's position is (1) that this obligation continued as to the lines here in question until their abandonment was permitted by the Interstate Commerce Commission even though prior to that time lessee did not keep those lines in good order and repair (R. 6a), (2) that until lessee was discharged of this obligation, petitioner suffered no loss, (3) that the order of the Interstate Commerce Commission did discharge the lessee and had the effect of determining the property rights of petitioner and its lessee with respect to those lines and thus made the case one of substance rather than of form, for which reason it is not controlled by *Old Colony Railroad Co. v. Commissioner*, 284 U. S. 552 (1932) as the respondent contends and as the Court below held, and (4) that the Transportation Act of 1920 did affect the rights under the lease of petitioner and its lessee as between themselves. Obviously, these are not questions "of pure fact".

2. Respondent contends that petitioner seeks the right to "accelerate or postpone the year of deduction" (p. 10). This is not correct. Under the lease petitioner has no right to initiate abandonment proceedings. Its lessee alone can do so. When lessee concludes that there is no likelihood of future traffic on the branch in question and that it therefore should be abandoned it files an application with the Interstate Commerce Commission. Petitioner therefore has no control over the time of the abandonment. Its first knowledge of the facts comes when lessee asks it to join in the application to the Interstate Commerce Commission. Under the decision of the lower court it is then too late for it to claim its loss for income tax purposes.

3. Respondent in his brief (p. 11) states that the question in *Thompson v. Texas Mexican R. Co.*, 328 U. S. 134 (1946):

> ". . . was whether maintenance of a suit in a state court, against a railroad company which was in reorganization under Section 77 of the Bankruptcy Act, was precluded by a stay order issued by the bankruptcy court and the provisions of Section 77 of the Bankruptcy Act."

This is only a half truth. As this Court stated (p. 142):

> "Second. Prior to the rendition of judgment on the merits the decision of the Interstate Commerce Commission was necessary on *two* phases of the controversy—one under § 77 of the Bankruptcy Act, *the other under provisions of the Interstate Commerce Act.*" (Italics supplied.)

It is petitioner's contention that the decision of the Court below conflicts with the principles enunciated by this Court in discussing this second phase in the *Tex-Mex* case (pp. 144-150). The principles laid down there are equally applicable to the instant case, for property rights must first be determined before either the Bankruptcy or the Internal Revenue laws may be applied.

From the practical as well as the legal standpoint the only time when petitioner can claim the loss is when the line is abandoned in accordance with authority of the Interstate Commerce Commission.

Respectfully submitted,

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February, 1951.